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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

----- In the Matter of -----)	
)	
PUBLIC UTILITIES COMMISSION)	DOCKET NO. 05-0002
)	
Instituting a Proceeding to Investigate the)	
Issues and Requirements Raised by, and)	
Contained in, Hawaii Revised Statutes)	
486H, as Amended)	
_____)	

SHELL OIL COMPANY'S REBUTTAL STATEMENT

AND

CERTIFICATE OF SERVICE

FILED
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PUBLIC UTILITIES
COMMISSION

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SHELL OIL COMPANY'S REBUTTAL STATEMENT

I. INTRODUCTION

There are only 51 days before the scheduled implementation. Despite this impending deadline, the position statements filed herein by parties confirm that there are currently *more questions than answers* about this law. In fact, there is not even consensus on what the law requires, let alone how the State of Hawaii is prepared to address the numerous irreparable adverse impacts that will likely flow from the implementation of this law.

As demonstrated by the position statements and by the PUC's own consultants, even if this law is implemented, there is no guarantee that gas prices will be reduced and, to the contrary, the street price of gasoline may in-fact increase. Such a result would not enhance the consumer welfare, and would underscore the flaws inherent in the approach now sought to be adopted.

Consequently, there is a compelling basis for the Governor to suspend the implementation of the law instead of needlessly subjecting the people of Hawaii to the uncertainties and adverse consequences that have been identified through this investigative process.

Shell respectfully submits that any process that would allow this law to take effect in less than 8 weeks is tantamount to economic experimentation. The PUC should undertake all efforts to avoid carrying out this scheduled implementation which will likely have a major adverse impact on the economy, welfare, and safety of the people of Hawaii.

By this rebuttal statement, Shell repeats its request that the PUC recommend to the Governor that she invoke her emergency powers to suspend the scheduled implementation of this law, pursuant to Haw. Rev. Stat. § 486H-15(a).

II. DISCUSSION

A. The Statements Confirm That The ICF Has Not Provided A Workable Plan For Implementation

Despite the various problems identified by the Consumer Advocate's own expert (MJ Ervin & Associates), the Consumer Advocate states that the ICF report "appears to be professionally competent." *See* CA Statement, at 5. In its statement, Shell has demonstrated, however, that the ICF report is materially flawed and that ICF has not provided a workable plan for implementation of the gasoline price caps. The statements filed by the other parties to this proceeding have also provided substantive evidence of the material flaws inherent in the proposed gas cap implementation, both as set forth in Haw. Rev. Stat. Chapter 486H (as currently drafted) and as recommended by ICF.

Of particular concern is ICF's propensity to abandon major aspects of its analysis upon simple questioning of the parties. While Shell has already identified substantive points in its statements, the other statements filed herein have also noted where ICF has backed off and changed the recommendations in the ICF report, such as:

- ICF's adjustments to marketing margins to reflect both relative land values and the effect of rent caps;

- ICF's recommendation that implementation be postponed and "calculation and monitoring" be used until after the ethanol mandate is in place;

- ICF's elimination of the cap on bulk sales;

- ICF's possible elimination of its proposed cap on unbranded rack sales;
- ICF's recommendation of a "gas cap monitoring and publication system" as opposed to a "hard compliance system" especially for "remote" locations;
- ICF's including inventory carrying cost in the import parity calculation;
- ICF's adjustments for potential increases in Panama Canal fees;
- ICF's correction of tariff assumptions for Rack margins in Atlanta and terminaling costs in Phoenix; and
- ICF's re-evaluation of Seattle margins using the Portland spot market in lieu of the Seattle barge market as a cost basis.

See Chevron Statement, at 4, 13-14, 17, 21, & 27; Tesoro Statement, at 9, 20-21, & 24; *see also* HPMa Statement, at 1-2, 8-10, 17 & 20 (citing to ICF's "calculation and monitoring", marketing margin adjustments and "monitoring and publication system").

Moreover, Shell has not been advised of any further work or follow-up to address these recommendations and contingencies that have now been proposed. Given the pattern which has been established in this proceeding, we expect that the parties will have many questions and concerns surrounding any follow up, just as there were significant questions and adjustments required for ICF's initial recommendations.

As set forth above, it is clear that ICF's back-pedaling from its published recommendations have left the PUC without a workable plan for implementation of the gasoline price caps. In addition, as discussed below, the ICF and the parties have identified serious risks to the supply of gasoline that have not been studied by ICF and cannot be adequately addressed by the PUC.

That we are less than 8 weeks before the scheduled implementation date of this law, and we do not even know what the formula to be implemented is, underscores the immediate need for intervention to prevent this law from currently taking effect.

B. The Statements Confirm That There Are Serious Risks To The Supply Of Gasoline In Hawaii

All of the statements submitted by the parties independently confirm that there are serious risks to the supply of gasoline in Hawaii:

First, Chevron's Dr. Teece opines that risks to supply include, among other things, the following: (1) distortions/dislocations in the market which are likely to result in "product outages at particular stations"; (2) on-island refiners closing due to lack of profitability; and (3) price caps do not provide for adjustments due to refinery outages or disruptions. *See* Chevron Statement, at 34-35. More troubling is Dr. Teece's opinion that: "given that retail prices are not regulated, to the extent that refiners have company-operated stations, it also would be rational to redirect product to those outlets, to the extent possible." *Id.* at 36.

While Shell vehemently objects to and does not waive any defenses it has to such a course of action by Hawaii's refiners, Chevron's expert raises a serious concern that Hawaii's refiners could attempt to circumvent any gasoline price cap by supplying gasoline exclusively to their company-operated stations. This could leave Shell and other non-refiners without gasoline while allowing Hawaii's refiners to control the price of gasoline in Hawaii. This could also subject Hawaii's consumers to both supply shortages and higher gasoline prices.

Second, the State's only other refiner, Tesoro, similarly indicates that if a price cap is implemented, the viability of Hawaii's refining industry may be jeopardized. *See* Tesoro Statement, at 2-3. Tesoro further indicates that it may *export* product by balancing "its production with market place alternatives both in and out of Hawaii." Tesoro Statement, at 4-5. As Tesoro puts it, this has the "potential for local supply disruption and shortages." *Id.* Exporting product does not appear far-fetched given the restrictive price caps compounded by the impending Ethanol requirements.

Third, like Chevron and Tesoro, HPMA recognizes that "the security of supply to jobbers will be jeopardized if the baseline and location adjustment are set too low by the PUC. There will be severe market disruptions if this happens." HPMA Statement, at 2. HPMA cites to ICF's failure to evaluate the chances of refineries closing. HPMA also quotes DBEDT's warning (which echoes Chevron and Tesoro's positions) that:

[i]f refiners are forced to accept lower margins in the Hawaii market, they may sell their product through uncapped channels of distribution such as exports from the state. If this occurs, Hawaii will face the real risk of product shortages."

Id. at 2.

Last, the Consumer Advocate carefully points out that consumer welfare is "not only a function of competitive market-driven prices, but also of surety of convenient supply and choice." CA Statement, at 9. The Consumer Advocate acknowledges the exportation of gasoline is a realistic option for Hawaii's refiners and could result in statewide gasoline shortages. *Id.* at 10. The Consumer Advocate recognizes that "the implementation of the Gas Cap law as recommended could lead to an increased risk of a

Hawaii refiner closing its Hawaii business” because “the economic viability of the State’s refiners would be threatened if they were unable to generate an adequate return on investment.” *Id.* at 11-12.

These risks to supply identified in each statement are fully consistent with ICF’s admission that its recommendations could lead to “a decrease in the available supply of gasoline within the state of Hawaii[.]” ICF’s Response to SHELL-IR-75(b). Thus, as demonstrated above, all parties agree with the ICF that the “implementation of the gas cap law as recommended in the Report could lead to an increased risk of a Hawaii refiner closing its Hawaii business[.]” which could result in a decrease in the available supply of gasoline in the state of Hawaii.” *See* ICF’s Response to SHELL-IR-76(a). This risk is too important to be ignored and confirms Shell’s position that the Gas Cap Law should not be implemented.

C. The Statements Confirm That There Are Serious Risks To The Supply Of Gasoline On The Neighbor Islands

All of the statements submitted by the parties confirm that there are serious risks to the supply of gasoline on the neighbor islands, particularly in remote areas of the neighbor islands.

For example, Tesoro recognizes that applying average cost concepts in zones means that service providers to rural mom and pop retailers, would become especially vulnerable. *See* Tesoro Statement, at 18. In addition, Tesoro points out that providing advanced wholesale price information to the market “in conjunction with limited gasoline storage *particularly on the neighbor islands*, will lead to erratic buying at the wholesale level and *potentially result in supply disruptions.*” *Id.* at 11 (emphasis added). Tesoro

further explains that the costs of transporting gasoline to the outer islands (e.g. substantial capital investments to comply with the Oil Pollution Act of 1990, costs of terminaling, barging and trucking) cannot be reasonably recovered under the price caps. *Id.* at 18; *see also* Chevron Statement, at 29-31 (zone pricing on average costs create concerns that “suppliers whose costs are above the average may be forced from the market” and “stations that are costlier to supply may suffer from supply shortages”); CA Statement, at 13-14 (“In a capped price environment, a wholesale marketer supplying a DTW account may see no way to cover their costs to service the account [in a remote location with a higher supply cost] and may cancel the supply contract.”).

In addition, HPMA’s position is that “the gas cap law will cause jobbers and other wholesale marketers the most economic harm.” HPMA Statement, at 1. HPMA’s reasoning is worth reciting here again because it highlights the fact that zone pricing will not only affect the supply of gasoline on the neighbor islands but could have far reaching effects to businesses government and thousands of workers:

Typical customers served by jobbers include farmers, hospitals, construction companies, schools, power plants, police and fire departments, state and federal government, hotels, car rental companies, the postal service and many more. The list of those who rely solely on jobbers to deliver their fuel is long and their contribution to Hawaii’s economy, *especially on the neighbor islands* and rural Oahu, is large. Businesses served by jobbers collectively employ tens of thousands of workers. If ICF’s recommended price caps are implemented, however, a number of jobbers could shut down, or their ability to deliver gasoline could be materially curtailed. That could leave their customers driving long distances and paying more to get the fuel they need to operate and continue in business.

Id. at 5.

Accordingly, all statements submitted provide further evidence of the fact that serious supply problems will occur in remote locations of the neighbor island. This raises the question posited by Shell in its statement: *what happened to the mandatory legislative task force that was supposed to address this problem and the report that was to contain recommendations to address these concerns including, if necessary, alternative legislation?* Absent the convening of the mandatory legislative task force and its fulfillment of its numerous duties, it is Shell's position that implementation of the price caps is dangerously premature if not outright illegal. See Shell Statement, at 26-51.

D. The Statements Confirm That There Is Serious Flaw In The ICF's Analysis Resulting From The Unknown Ethanol Impact

All of the statements submitted by the parties confirm that the failure to address the impact of the ethanol blending requirements is a serious flaw in ICF's analysis.

For example, Chevron's expert cited the same sections from ICF's responses and report that Shell did in its statement regarding the ethanol impact: ICF recommends "calculation and monitoring" until the ethanol requirement is "in place and functional" and ICF did not perform an analysis of the ethanol impact. See Chevron Statement, at 26-28. In addition, Chevron's expert provided evidence of the ethanol impact by describing to the higher margins for ethanol blended gasoline in New York. *Id.* at 27-28. Chevron's expert reached the same conclusion as Shell that in seven months, ICF's analysis and recommendations will simply be irrelevant as a result of the Ethanol legislation. *Id.* at 28; see also Tesoro Statement, at 3-4 (noting in its discussion regarding Tesoro's consideration of business alternatives that Ethanol blending is "expected to generate additional capital requirements as well as manufacturing and operational issues

for Tesoro Hawaii and the state” which are not accounted for in the price caps); HPMMA Statement, at 1-2, 8-10 (citing ICF’s “calculation and monitoring” recommendation and quoting ICF’s warning that “uncertainty around the costs and ability to initially acquire and blend ethanol from outside Hawaii is a greater challenge and issue than the gas caps.”); CA Statement, at 17-18 (citing to ICF recognition of the uncertain effect and problems of ethanol blending).

The failure to address the ethanol impact is without question a material flaw that calls into question the quality of ICF’s entire analysis. This failure further renders the ICF plan obsolete as soon as the ethanol blending requirements take effect in a matter of months.

E. The Statements Confirm The Problems With The Proposed Monitoring And Enforcement Proposals

The statements provided raise concerns about the proposed monitoring and enforcement of the gasoline price caps which supports Shell’s position that ICF’s proposal for monitoring and enforcement are incomplete, unrealistic, contain numerous pitfalls and are likely unconstitutional.

For instance, Tesoro cites to numerous legal obligations regarding the use of Tesoro’s information including maintenance of confidentiality and reporting requirements consistent with Sarbanes-Oxley, securities and antitrust laws. *See* Tesoro Statement, at 19. Tesoro rightfully questions whether its trade secret and other proprietary information will be securely maintained by the PUC and not released or accessed by competitors and others. *Id.*

In their statements, the parties note that there will be significant costs of compliance with the gasoline price cap which are not provided for in Haw. Rev. Stat. Chapter 486H or ICF's proposal. Chevron's expert explains that ICF's proposed program will lead to monitoring and enforcement costs for those transacting business as well as the PUC itself. *See* Chevron Statement, at 41. Chevron's expert further opines that the costs of administration and enforcing the cap program are likely to be significant when you consider the costs in monitoring information provided, adjudicating price cap violations, and arbitrating disagreements between buyers and sellers over the price cap amounts. *Id*; *see also* Tesoro Statement at 20 (inability to recover significant costs associated with compliance will erode participant's ability to earn fair rate of return); HPMa Statement, at 16 (ICF has not included "any mechanism for marketers to recoup cost of compliance with this price-cap system.").

The above concerns are in addition to the problems regarding the inability of the PUC to verify the accurateness of the information provided to it and the use of external data sources such as Platt's, which themselves contain errors. *See* Shell Statement, at 51-54.

Imposing arbitrarily enforced minimum penalties of \$50,000/day for failure to provide accurate information to the PUC and \$250,000 penalties/occurrence of overcharges on top of an unreliable price cap that does not allow refiners to obtain a reasonable rate of return is like adding fuel to the fire. Under this scenario, it would not be long before refineries conclude it is no longer profitable to continue doing business in the Hawaii market.

F. The Statements Confirm That The Law Cannot Be Implemented In Full
On September 1, 2005

Virtually all of the Parties, and ICF itself, have now recommended against full implementation of this law.¹

Shell and Chevron have urged the PUC to expressly recommend to the Governor that she invoke her emergency powers granted to her under Haw. Rev. Stat. § 486H-15(a) to suspend the implementation of this law. *See* Shell Statement at p. 65; Chevron Statement at p. 1.

ICF has now taken the position that “the scope of the Ethanol issue, and the time to fully understand the impact on Ethanol cost, supply and storage is a basis to recommend to the PUC that the Gas Cap implementation be initiated on a ‘calculation and monitoring’ basis until the Ethanol mandate is in place and functional.” *See* ICF’s Response to CA-IR-1. HPMa similarly recommends that “the regulations should be implemented on a calculate and monitor basis until the PUC and ICF better understand the ramifications of the proposed caps on the unique characteristics and situations of the Hawaii marketplace.” *See* HPMa Statement at p. 3. The CA also takes the position that it “would consider supporting such a system to provide additional time and information to better assess the impacts of the regulation.” *See* CA Statement at p. 18.

Thus, all participants in this docket, including the PUC’s own expert, do not recommend full implementation of Act 242 on September 1, 2005. Shell respectfully

¹ While Tesoro’s Statement did not contain an express recommendation against full implementation of Act 242 on September 1, 2005, it did note that “[n]othing good will result for any stakeholder – business, government, consumer, public or private – in the Hawaii energy community from Act 242.” *See* Tesoro Statement at p. 2.

submits that it would be difficult for the PUC to take any action inconsistent with this position.

The relevant question then becomes what action should the PUC take.

As noted at pp. 38 – 40 of its statement, Shell explained that given Act 242's mandatory language *requiring* the legislative task force to address the impact of the gasoline price cap law on the neighbor islands, it is entirely appropriate and reasonable for the PUC to interpret Act 242 to require that the legislative task force be convened and perform its duties *prior to* the PUC's implementation of the law. There is no dispute that this legislative requirement was not complied with. Therefore, contrary to the CA's statements that implementation is required absent a change in the Gas Cap law, the PUC should take the position that it is currently not able to proceed with implementation given the legislature's failure to meet this requirement. *See* Shell's Position Paper at pp. 38 – 40.

Moreover, the PUC's interpretation of Act 242 requiring that the mandatory legislative task force be convened and perform its duties prior to implementation of the price caps will be accorded substantial deference under established Hawaii law. Where an agency is statutorily responsible for carrying out the mandate of a statute which contains broad or ambiguous language, that "agency's interpretation and application of the statute is generally accorded judicial deference on appellate review." *TIG Ins. Co. v. Kauhane*, 101 Hawaii 311, 321, 67 P.3d 810, 820 (Ct.App. 2003). Here, there is little question that the PUC is charged with implementing the gasoline price cap. In fact, the PUC must: (a) collect information from manufacturers, wholesalers, and jobbers; (b) determine and publish the maximum prices including the base line prices and adjustment

factors including zone price adjustments; (c) determine the extent of compliance by manufacturers, wholesalers, and jobbers; (d) adopt rules pursuant to chapter 91 as may be necessary to implement the gas cap law; and (e) report to the governor and the legislator significant aberrations, trends or conditions that may adversely impact gasoline consumers. *See* Haw. Rev. Stat. § 486H-13. Accordingly, the reasonable and prudent position for the PUC to take is that, under the present circumstances, it has no ability to proceed with any implementation of this law. This position is consistent with Shell and Chevron's position.

As also noted above, the only other feasible alternative would be to follow ICF's recommendation to only partially implement the law on a "calculation and monitoring" basis. HPMA does not appear to believe there is any impediment to the PUC to take this course of action. The CA, however, takes the position that it "does not believe that the law allows for only a 'calculation and monitoring' system without a change in the Gas Cap Law[,]" but also goes on to state that a change "is beyond the Commission's authority." *See Id.* Shell respectfully disagrees with this assertion.

In addition to the PUC's ability to refuse to implement the law when mandatory conditions have not been met, under Haw. Rev. Stat § 486H-13(n), the PUC "shall report to the governor and the legislature, in a timely manner, on any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State." Haw. Rev. Stat. § 486H-13(n) (emphasis added). Thus, where the PUC knows of a condition that "may" adversely impact gasoline consumers, then it must make a timely report to the Governor and Legislature.

Moreover, the PUC's report to the governor is crucial in that it compels the governor to determine whether to use her "emergency powers" to suspend the gasoline price caps under Haw. Rev. Stat. § 486H-15:

(a) Notwithstanding any law to the contrary, the governor may suspend, in whole or in part, section 486H-13 or any rule adopted pursuant to that section whenever the governor issues a written determination that strict compliance with the section or a rule will cause a major adverse impact on the economy, public order, or the health, welfare, or safety of the people of Hawaii. In the written determination, the governor shall state the specific provision of the section or rule that strict compliance with will cause a major adverse impact on the economy, public order, or the health, welfare, or safety of the people of the State, along with specific reasons for that determination. The governor shall publish this determination in accordance with section 1-28.5. The suspension shall take effect upon issuance of the written determination by the governor.

Haw. Rev. Stat. § 486H-15 (emphasis added).

Shell has provided its substantive discussion at pp. 60-62 of its statement confirming the role the PUC now has in making its timely recommendation to have the Governor invoke her emergency powers under the law, to suspend the September 1, 2005 implementation of this gas cap law.

III. CONCLUSION

It should be noted that this rebuttal does not address countless other issues that warrant discussion on this matter² including: the legal flaws inherent in both Haw. Rev. Stat. Chapter 486H and as recommended by ICF – and the likely legal challenges that

² Shell does not waive its legal and equitable arguments regarding issues not addressed herein. Shell expressly reserves its right to address such issues at later time in this proceeding and/or in any subsequent proceedings/actions.

will inevitably ripen should implementation be authorized; and the troubling price impact – leading to the potentially embarrassing result of actually leading to higher gas prices for the consumers of Hawaii.

It is clear that this “investigative” proceeding has produced more questions than answers. That it is a mere 51 days before the scheduled implementation, and there is no consensus on what key provisions will hold, nor any plan to address what the accepted impacts will be, is extremely prejudicial to the parties in this case, the PUC, and most importantly, the consumers of the State of Hawaii.

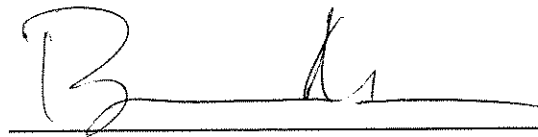
The Consumer Advocate acknowledges these problems, but chooses to call them “just . . . risks.” CA Statement at 26. However, it is likely that the petroleum parties and consumers on the neighbor islands will irreparably suffer the adverse consequences identified in this investigation. As noted by the record in this case - these parties certainly do not consider these issues as “just risks.” In view of these concerns, we would respectfully offer that the Consumer Advocate has a statutory duty to “represent, protect, and advance the interest of *all* consumers[,]” not just those on Oahu.

Moreover, even assuming *arguendo* that the risk of a refinery closing is only moderate, the resulting harm would be so great that any “risk” is unacceptable. Under established Hawaii law, the PUC’s duty to act “fairly and justly” toward the public “is of paramount importance.” See *In re Honolulu Gas Co.*, 33 Haw. 487, 495 (1935). Indeed, the PUC has the duty, and the power, to steer this State away from this misguided path. As such, it is of “paramount importance” that the PUC now fulfill its statutory obligation

under Haw. Rev. Stat. Chapter 486H and to take all appropriate action to stop the scheduled implementation of this flawed law. *See Id.*

For the reasons set forth herein and as offered in its opening statement, Shell respectfully requests that the PUC recommend that the Governor immediately invoke her statutory emergency powers to suspend the scheduled September 1, 2005 implementation of this law.

DATED: Honolulu, Hawaii July 11, 2005.

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CERTIFICATE OF SERVICE

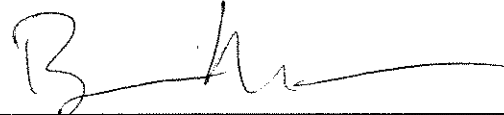
The undersigned hereby certifies that a true and correct copy of the above document was duly served upon the following parties in the manner described at their following last known addresses:

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DATED: Honolulu, Hawaii, July 11, 2005.

A handwritten signature in black ink, appearing to read "B. Higa", written over a horizontal line.

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